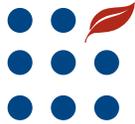




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The Changing Tobacco User's Dollar

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Abstract

U.S. consumers spent \$86.7 billion on tobacco products in 2003, about \$1.5 billion less than in 2002. Overall, consumer expenditures are declining as lower consumption outweighs higher costs facing tobacco product users. About 94 percent of expenditures were for cigarettes. For cigarettes, a larger part of the consumer's dollar went to taxes and manufacturers, while wholesalers, retailers, and farmers took less. Since 1998, wholesale cigarette prices have jumped 122 percent and excise tax rates (Federal and State) have increased 74 percent. The farmer's share of the tobacco user's dollar declined from 1998-2003 because domestic cigarette consumption fell and use of imported tobacco increased. Gains in the manufacturers' share (due to higher wholesale prices) overwhelmed other share categories. Cigarette manufacturers raised prices partially to cover expenses incurred as a result of the Master Settlement Agreement.

Keywords: Tobacco expenditures, cigarette prices, cigarette consumption, excise taxes, and tobacco products.

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Introduction

Expenditures on tobacco products of the United States trended upward for many years, reaching a record high \$88.2 billion in 2002 before slipping to \$86.7 billion in 2003. During the past two decades, higher prices for cigarettes (the main consumption category) and higher excise taxes offset declining cigarette consumption, boosting total consumer expenditures through 2002 (table 1). In 2003, the effects of lower consumption overtook the effects of rising costs, diminishing consumer expenditures.

Tobacco product expenditures in 2003 comprised 1.11 percent of consumer disposable income, compared with 0.96 percent in 1998. About 1.04 percent of disposable income went for cigarettes, 0.03 percent for cigars, and 0.04 percent for other tobacco products (smoking tobacco, chewing tobacco, and snuff).

During the 1920s, cigarettes emerged as the leading form of tobacco consumption, and by the mid-1950s and early 1960s accounted for 85-90 percent of expenditures on tobacco products. Rising expenditures on cigarettes during the last two decades reflect rising prices and rising taxes. After peaking at 640 billion in 1981, cigarette consumption declined an average of 2 percent annually to 400 billion cigarettes in 2003. This decline occurred despite increases in both the smoking age population and disposable income. At the same time, the consumer cost of cigarettes increased steadily, except during a brief period in the early 1990s.

Retail prices for cigarettes increased sharply over the last decade, primarily because of rising wholesale prices (fig. 1). Wholesale prices of branded filter-tipped cigarettes (excluding excise taxes) have more than doubled since January 1990. During the early and mid-1990s, consumers began shifting to

Table 1—U.S. Expenditures for tobacco products and disposable personal income, 1990-2003¹

Year	Total	Cigarettes	Cigars ²	Other ³	Disposable personal income	Percent of disposable personal income spent of tobacco products			
						All	Cigarettes	Cigars ²	Other ³
Million dollars					Billion dollars	Percent			
1990	41,920	39,500	695	1,725	5,324	1.04	0.98	0.02	0.04
1991	45,305	42,850	705	1,840	5,352	1.08	1.02	0.02	0.04
1992	48,470	45,790	715	1,965	5,536	1.08	1.02	0.02	0.04
1993	48,955	46,150	730	2,075	5,594	1.04	0.98	0.02	0.04
1994	47,297	44,544	766	1,987	5,746	0.96	0.90	0.02	0.04
1995	48,692	45,793	846	2,053	5,906	0.92	0.86	0.02	0.04
1996	50,363	47,233	1,012	2,118	6,081	0.90	0.85	0.02	0.04
1997	52,167	48,734	1,229	2,205	6,296	0.90	0.84	0.02	0.04
1998	57,273	53,236	1,607	2,430	6,664	0.96	0.88	0.03	0.04
1999	70,715	66,286	1,796	2,633	6,861	1.03	0.97	0.03	0.04
2000	77,705	72,945	1,926	2,833	7,194	1.08	1.01	0.03	0.04
2001	82,919	77,845	2,121	2,953	7,320	1.13	1.06	0.03	0.04
2002 ⁴	88,174	82,873	2,224	3,077	7,597	1.16	1.09	0.03	0.04
2003 ⁵	86,638	81,070	2,319	3,249	7,798	1.11	1.04	0.03	0.04

¹Expenditures exclude sales tax.

²Includes small cigars (cigarette-size).

³Smoking tobacco, chewing tobacco, and snuff.

⁴Subject to revision.

⁵Estimated.

Source: Compiled from reports of U.S. Department of Labor, Bureau of Labor Statistics.

generic cigarette brands in the face of rising prices. In August 1993, cigarette companies lowered prices on premium brands and regained market share, but prices began rising again the following year. In 1998, the Master Settlement Agreement (MSA) was signed, and cigarette manufacturers immediately boosted wholesale prices by 45 cents per pack, the largest increase ever, to cover the costs of the settlement ¹

Tobacco Taxes

In 2003, excise taxes represented 23 percent of consumer expenditures on tobacco products, 2 percentage points lower than in 1998 (table 2). However, in absolute terms, the excise tax increases more than doubled, rising by 15 cents per pack (20 cigarettes) in 2000 and another 5 cents per pack in 2002 to its current 39 cents per pack. Federal tax collections in 2003 were \$7.3 billion compared with \$5.3 billion in 1998.² State and local excise taxes have risen by 43 percent since 1998. Since the beginning of 2000, 31 States (including the District of Columbia and U.S. territories) have increased cigarette excise taxes. The average State cigarette excise tax (weighted by packs taxed) at the end of 2003 was 61.95 cents per pack, compared with 34.87 cents per pack in 1998. State and local excise tax collections have risen, reflecting the higher rates. In 2003, State and local excise tax collections were estimated at \$11.4 billion, compared with \$8.0 billion in 1998. State excise tax collections have exceeded Federal excise collections since 1986.

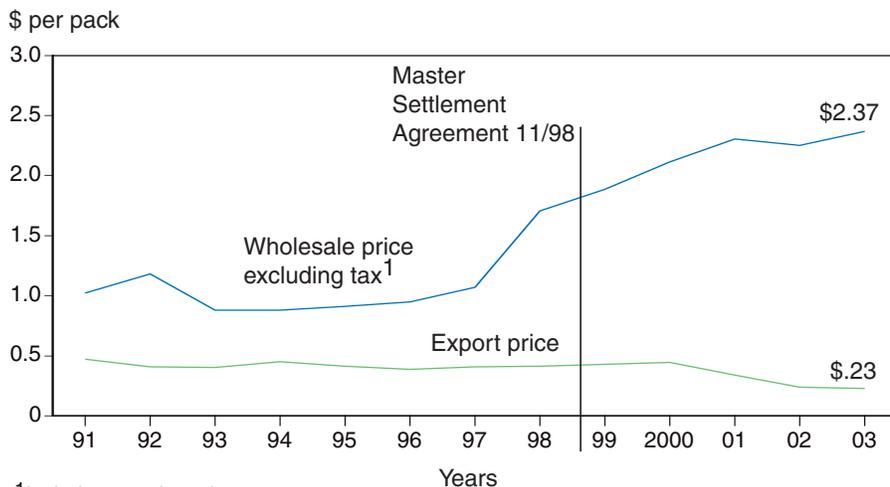
In fiscal year 2003, tobacco products accounted for 0.42 percent of total Federal tax receipts and represented nearly 12 percent of total Federal excise tax collections. Iowa imposed the first cigarette excise tax in 1921. By 1950, 40 States and the District of Columbia taxed cigarettes, and by 1970, all 50 States taxed them. State excise taxes currently range from 2.5 cents per pack in Virginia (set to increase later in 2004) to \$2.05 per pack in New Jersey. Nineteen States and the District of Columbia currently have tax rates over \$1.00 per pack. Thirty-three States have excise taxes of 50 cents or greater. About 98 percent of tobacco tax revenue is from cigarettes. However, the Federal excise tax also applies to cigars, snuff, chewing

¹The Master Settlement Agreement (MSA) between the attorneys general from 46 States and the major cigarette companies was intended primarily to reimburse States for expenses related to the treatment of smoking-related illnesses. The agreement also contained provisions to reduce the incidence of smoking, especially among youth. Four States not included in the MSA signed separate agreements with the cigarette manufacturers [see Capehart, <http://www.ers.usda.gov/publications/tbs/oct01/tbs250-01/>]

²Excise taxes are taxes paid when purchases are made on a specific good such as cigarettes. Excise taxes are usually included in the price of the product. Excise taxes are levied at the Federal, State, and sometimes local levels.

Figure 1

Cigarette prices, 1990-2003



¹Includes premium cigarettes.

Source: Industry publications and Bureau of the Census.

tobacco, and pipe smoking tobacco. Forty-seven States tax both cigarettes and other tobacco products, compared with 44 in 1998 and 35 in 1991.

Tobacco products have been taxed by the Federal Government since the mid-19th century. At the end of World War II, the Federal excise tax on cigarettes was 7 cents per pack of 20 cigarettes. Since then, Federal tax rates have increased several times.³ Recently, the Federal excise tax increased to 34 cents per pack on January 1, 2000, and rose another 5 cents per pack on January 1, 2002. From 1983-86, Federal tax collections exceeded State taxes as they did during the 1950s. Since 1986, State collections have exceeded Federal revenues from tobacco

³Federal taxes increased to 8 cents per pack in 1951, 16 cents in 1983, 20 cents per pack in 1991, 24 cents per pack in 1993, 34 cents per pack in 2000, and 39 cents per pack in 2002.

The Cigarette Dollar

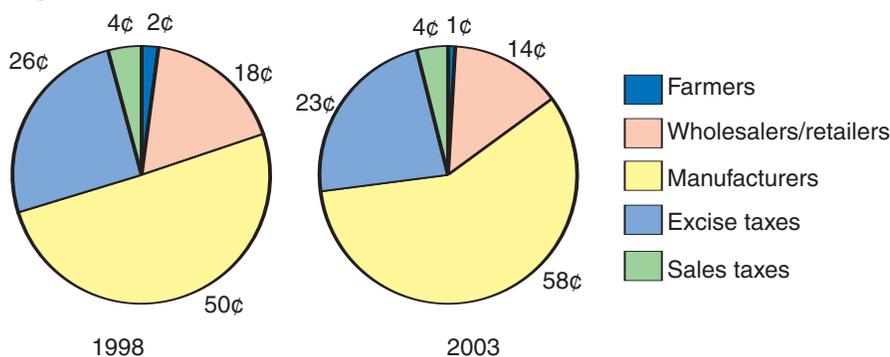
Farmers received about 1 cent of the consumers' cigarette dollar in 2003, compared with 2.1 cents in 1998 (fig. 2 and table 2). Although leaf prices have been rising, the volume of U.S. tobacco used by cigarette manufacturers has declined substantially. In 2003, U.S. growers provided less than half the tobacco made into cigarettes as imports from Brazil, Argentina, Malawi, and Thailand increased. The manufacturing sector (including all stages of leaf processing) accounted for 57.9 cents, a significant gain from 1998's 50.4 cents. The 7.5-cent advance is due largely to increases in wholesale cigarette prices and other costs of manufacturing cigarettes, such as MSA payments, materials, interest, labor, legal fees, and imported leaf tobacco. In 2002, the manufacturers' share peaked at 58.7 cents. Its decline in 2003 was most likely due to the 4-percent drop in cigarette consumption. The wholesale-retail portion of the manufacturers' share slipped from 17.8 cents in 1998 to 14.1 cents. The Federal excise tax share slipped from 10.2 cents per dollar to 9 cents. Cigarette price increases outpaced tax gains. State and local taxes slipped to 14.1 cents in 2003, from 15.4 cents in 1998. Total excise taxes took 23.1 cents out of every dollar, compared with 25.5 cents in 1998. Sales taxes added another 3.9 cents in 2003.

Cigarette Marketing Bill

The U.S. marketing bill for cigarettes totaled \$58.3 billion in 2003, compared with \$35.4 billion in 1998. Marketing costs represented about 72 percent of consumer spending on cigarettes in 2003, 4 percentage points more than in

Figure 2

Cigarette user's dollar



1998 (table 2). The marketing bill is comprised of manufacturing (including MSA payments) and wholesaling-retailing costs. It is calculated as consumer expenditures minus the sum of farm value and total taxes. During 1998-2003, the manufacturers' share of consumer spending on cigarettes advanced from 50 percent to 58 percent. In contrast, the wholesaler-retailer portion fell from 18 percent to 14 percent. The manufacturing bill includes charges for assembling, stemming, redrying, storing, and aging tobacco, converting tobacco (including foreign-grown tobacco) to cigarettes, and distributing them to wholesalers and retailers. Beginning in 1999, the marketing bill also included substantial MSA payments from manufacturers to States participating in the agreement.

Cigarette excise taxes are included in the retail price. The excise tax share of expenditures has slipped slightly during the last decade, with the State and local tax share rising more than the Federal share. The State sales tax share also declined. However, actual tax collections have increased sharply in dollar terms.

Table 2—Total expenditures, farm value, and marketing bill for cigarettes, U.S., 1990-2003

	Consumer expenditures	Farm value	Marketing bill			Excise taxes			Sales taxes	Total taxes
			Manufacturing ¹	Wholesaling-retailing	Total	Total	Federal	State & local		
<i>Million dollars</i>										
1990	39,500	1,360	21,294	6,799	28,093	9,907	4,121	5,786	1,500	11,407
1991	42,850	1,075	22,810	6,190	29,001	11,069	4,913	6,156	1,706	12,775
1992	45,790	1,155	25,678	5,561	31,239	11,323	4,997	6,326	2,073	13,396
1993	46,150	970	25,082	6,329	31,411	11,759	5,299	6,460	2,009	13,768
1994	44,544	1,190	20,170	8,277	28,447	12,892	5,807	7,085	2,016	14,908
1995	45,793	1,074	20,695	8,919	29,614	13,104	5,697	7,407	2,000	15,104
1996	47,233	1,248	21,373	9,375	30,748	13,224	5,752	7,472	2,013	15,237
1997	49,437	1,121	23,061	9,989	33,050	13,263	5,666	7,597	2,003	15,266
1998	51,987	1,098	26,201	9,229	35,431	13,277	5,294	7,983	2,181	15,458
1999	66,286	1,018	37,141	12,693	49,834	13,023	5,061	7,962	2,411	15,434
2000	72,945	947	44,721	9,237	53,958	15,671	7,313	8,357	2,371	18,041
2001	77,845	795	48,361	10,475	58,835	15,313	6,944	8,369	2,902	18,215
2002	82,873	822	48,676	12,819	61,495	17,205	7,719	9,486	3,351	20,556
2003	81,070	800	46,921	11,422	58,343	18,734	7,334	11,400	3,193	21,927
<i>Percent of consumer expenditures</i>										
1990		3.4	53.9	17.2	71.1	25.1	10.4	14.6	3.8	28.9
1991		2.5	53.2	14.4	67.7	25.8	11.5	14.4	4.0	29.8
1992		2.5	56.1	12.1	68.2	24.7	10.9	13.8	4.5	29.3
1993		2.1	54.3	13.7	68.1	25.5	11.5	14.0	4.4	29.8
1994		2.7	45.3	18.6	63.9	28.9	13.0	15.9	4.5	33.5
1995		2.3	45.2	19.5	64.7	28.6	12.4	16.2	4.4	33.0
1996		2.6	45.2	19.8	65.1	28.0	12.2	15.8	4.3	32.3
1997		2.3	46.6	20.2	66.9	26.8	11.5	15.4	4.1	30.9
1998		2.1	50.4	17.8	68.2	25.5	10.2	15.4	4.2	29.7
1999		1.5	56.0	19.1	75.2	19.6	7.6	12.0	3.6	23.3
2000		1.3	61.3	12.7	74.0	21.5	10.0	11.5	3.2	24.7
2001		1.0	62.1	13.5	75.6	19.7	8.9	10.8	3.7	23.4
2002		1.0	58.7	15.5	74.2	20.8	9.3	11.4	4.0	24.8
2003		1.0	57.9	14.1	72.0	23.1	9.0	14.1	3.9	27.0

¹Estimated by multiplying average wholesale price less taxes by taxable removals.

Consumer Expenditures on Tobacco Products May Have Peaked

The effects of the MSA will continue to be felt by cigarette consumers in the form of higher prices. State excise taxes will likely continue to increase, although probably not at the rate seen in recent years. Manufacturers face continued falling domestic volume and export demand, and wholesale prices will likely continue to increase. Tax rates of State and local governments will also likely continue to rise, but perhaps not as quickly as during the 1990s.

Is 2003 the beginning of a downward trend for consumer expenditures on cigarettes? It is likely, given increased competitiveness in the cigarette industry since the MSA took effect. New entries in the market and the popularity of lower-priced discount cigarettes will moderate cigarette price increases which, combined with lower consumption ([table 3](#)), will likely result in reduced expenditures. Although consumption has been trending downward since 1981, expenditures continued to increase due to rising taxes, expenses associated with the MSA, and increased business expenses.

Table 3—Cigarettes: U.S. output, removals, and consumption, 1950-2003

Year	Total output	Taxable removals ²	Overseas forces and shipments ¹	Exports	Total U.S. consumption ³
<i>Billion pieces</i>					
1960	506.9	470.1	16.8	20.2	484.4
1961	528.3	488.1	17.4	22.2	502.7
1962	535.5	494.5	17.0	24.1	508.4
1963	550.6	509.6	17.5	23.6	523.9
1964	539.9	497.4	17.5	25.1	511.2
1965	556.8	511.5	21.1	23.1	528.7
1966	567.3	522.5	22.6	23.5	541.2
1967	576.2	527.8	25.3	23.7	549.2
1968	579.5	523.0	27.3	26.5	545.7
1969	557.6	510.5	22.1	25.0	528.9
1970	583.2	532.8	22.1	29.2	536.4
1971	576.4	528.9	17.4	31.8	555.1
1972	599.1	551.0	14.4	34.6	566.8
1973	644.2	590.3	14.4	41.5	589.7
1974	635.0	576.2	12.3	46.9	599.0
1975	651.2	588.3	12.1	50.2	607.2
1976	693.4	617.9	10.7	61.4	613.5
1977	665.9	592.0	11.3	66.8	617.0
1978	695.9	614.2	10.8	74.4	616.0
1979	704.4	614.0	14.1	79.7	621.5
1980	714.1	620.5	12.2	82.0	631.5
1981	736.5	638.1	9.4	82.6	640.0
1982	694.2	614.1	8.5	73.6	634.0
1983	667.0	597.5	9.0	60.7	600.0
1984	668.8	597.8	10.6	56.5	600.4
1985	665.3	595.0	7.6	58.9	594.0
1986	658.0	583.1	10.0	63.9	583.8
1987	689.4	577.2	11.0	100.2	575.0
1988	694.5	543.4	10.2	118.5	562.5
1989	677.2	525.8	7.3	141.8	540.0
1990	709.7	523.2	14.5	164.3	525.0
1991	694.5	497.1	14.5	179.2	510.0
1992	718.5	509.4	7.4	205.6	500.0
1993	661.0	463.4	6.5	195.5	485.0
1994	725.5	488.6	11.4	220.2	486.0
1995	746.5	490.3	19.8	231.1	487.0
1996	754.5	486.0	17.1	243.9	487.0
1997	719.6	471.4	15.0	217.0	480.0
1998	679.7	457.9	11.2	201.3	465.0
1999	606.6	429.8	14.1	151.4	435.0
2000	594.6	423.3	5.4	148.3	430.0
2001	562.4	411.7	10.8	133.9	425.0
2002 ⁴	497.0	394.9	2.6	127.4	415.0
2003 ⁴	499.4	375.0	3.6	121.4	400.0

¹To Puerto Rico and other U.S. possessions. Also includes military shipments, ship stores and small tax-exempt categories.

²Taxable removals are cigarettes taken from factory warehouses with Federal tax paid.

³Allows for estimated inventory change for 1971-2003.

⁴Estimated.

Source: Compiled from reports of the Tobacco Tax and Trade Bureau, Bureau of the Census.

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